Two presidential appointees were recently sworn in as governors of the Federal Reserve Board. As hearings in the U.S. Senate proceeded toward confirmation, the popular labels “hawk and dove” flew freely as Fed watchers sought clues for shifts in thought among the appointees. The new governors, Janet Yellen and Sarah Raskin, will serve on the Federal Open Market Committee (FOMC), the body charged with conducting monetary policy.

Labels never fit well, though, and today hawk and dove are even more relative as monetary policy has achieved a certain consensus about some issues, particularly the relationship between inflation and long-run unemployment. Macroeconomics and monetary policy today are better understood than in the 1960s, ’70s, and ’80s. Core principles include a priority for stable prices, an inflation target (either explicit or implicit), and the conditioning of expectations in a way that doesn’t surprise markets.

Then and Now
The FOMC comprises 19 members, 12 of whom are voting members. The seven Board governors (when fully staffed) and the New York Fed president always vote, along with a rotating group of four Reserve Bank presidents. After its deliberations, the FOMC issues a statement directing the New York Fed to make the trades that influence the availability of credit in the economy. The Banking Act of 1935 created the committee and, for many years, participants and voting members alike were bankers and lawyers, not economists.

That’s no surprise. Back when the Federal Reserve System was formed in 1914, the job of the regional Reserve Banks was to issue currency and, later, to sort checks. The Reserve Banks also were lenders of last resort, issuing loans to banks through the discount window. Those staffing the Reserve Banks back then were typically former commercial bankers.

In those first two decades, monetary policy wasn’t considered part of the Reserve Banks’ mission, says Jerry Jordan, former Cleveland Fed president. He also served on the Council of Economic Advisers under President Ronald Reagan and as former research director of the St. Louis Fed. When the FOMC was formed, Board chairman and banker Marriner Eccles wanted to minimize the role of the Reserve Bank presidents.

The first three of the eight FOMC chairmen were in business or banking. One of the longest serving and most influential was William McChesney Martin. He chaired the FOMC from 1951 through 1970. The FOMC of the 1950s generally responded to increases in expected inflation by raising the federal funds rate in a manner consistent with that of the inflation-taming 1980s and 1990s, according to economists who have studied that era.

By the 1960s, Board staff and governors included more economists, but few Reserve Bank presidents were economists. That could be a handicap at meetings, Jordan says. “So, if you had a staff in Washington conversant with economic models and some (academic) governors, then that put the Reserve Bank presidents at a disadvantage.” The communication gap could be dramatic under some chairmen. For example, Arthur Burns was the first academic economist to chair the Board. A professor of economics at Columbia University, he served under Presidents Richard Nixon and Jimmy Carter during most of the 1970s.

“Arthur’s style was to pick on somebody at every meeting,” Jordan remembers. “By picking on him, he
intimidated other people who were not willing to be associated with whoever was being picked on.”

Over time, Reserve Banks built individual research departments, and research directors often attended FOMC meetings with Bank presidents. There, they often engaged in policy discussions. Richmond had one of the earliest departments in the system, recalls economist Dewey Daane, now an emeritus professor at Vanderbilt University. Daane joined the Bank’s research department in 1939, directed from 1937 until 1949 by University of Virginia economist Elbert Kincaid. Here’s how Daane recalls his introduction to the FOMC: “The [Richmond Fed] president called me into the office and said, ‘I think the presidents are going to get mixed up more in the monetary side. I don’t know anything about that. You’ll have to help me.’” Daane later served two terms on the Board of Governors, from 1963 through 1974.

By the 1970s, more economists began moving into Reserve Bank presidencies. Some Reserve Banks have had relatively few presidents since 1914; tenure averages nearly 11 years. The Richmond Fed has had only seven presidents. “What that means is that the Reserve Bank presidents are the institutional memory of the Federal Reserve,” says William Poole, who was president of the St. Louis Fed from 1998 until March 2008.

The Federal Reserve Act calls for diverse representation from not only financial, but also agricultural, industrial, and commercial, interests. In fact, William McChesney Martin objected, in 1966, to the appointment of economist Andrew Brimmer. Nothing personal, he said, he simply didn’t want another economist, citing the Act, according to Allen Meltzer’s A History of the Federal Reserve. Early Board governors were, like Reserve Bank presidents, likely to be bankers, businessmen, or lawyers.

Governors today may be economists, among them well-known academics like Ben Bernanke, but they also may be nominated for their specialty knowledge in business or law. In addition to FOMC duties, they also head committees that govern the Board. Of the current six Board members, two hold doctorates in economics.

Go-Stop

By the 1970s, more economists were serving on the FOMC, but they could not steer the nation out of growing inflation. The 1970s have been deemed a time of “disarray” in monetary policy by Marvin Goodfriend, a former long-time Richmond Fed economist now at Carnegie Mellon University. In a Journal of Economic Perspectives paper, “How the World Achieved Consensus on Monetary Policy,” Goodfriend outlines the debates.

Policymakers debated the inflation process. The division broke down between those who thought unions, monopoly firms, or outside shocks such as oil and food prices caused inflation, and the monetarists, who blamed the increase in the money supply. A belief was widely held that expansive monetary policy, a lower federal funds rate to stimulate the
output, could permanently reduce unemployment. That policy could be inflationary, and often was. But it could be worthwhile, providing inflation didn’t get out of hand.

Burns, for one, believed in “the power of many corporations and trade unions to exact rewards that exceed what could be achieved under conditions of active competition.” This power drove costs and prices “that may be cumulative and self-reinforcing,” according to Burns’ testimony in Congress quoted by Richmond Fed economist Robert Hetzel in his book The Monetary Policy of the Federal Reserve. But, absent money supply increases, union or monopoly power arguably couldn’t raise the general price level. Though workers might negotiate higher wages, firms would be hard-pressed to pass costs to consumers.

Burns ran the committee forcibly and fell prey to political pressure by some accounts. Former Richmond Fed President Al Broadus attended FOMC meetings under three chairmen, including Burns. A chairman, he notes, can exert tremendous influence, sometimes usefully and sometimes not. “If a chairman discourages discussion as Burns sometimes did, in my view, you will lose the value of the debate to help understand policy challenges you need to face.” But the reverse is also true. If the chairman doesn’t control the meeting flow, then excessive, free-form discussion may hinder the committee’s work.

The Burns era is crucial to understanding today’s thinking about monetary policy. Though Burns took a public stand against inflation, the federal funds rate fell from an average of 8.02 percent in the first quarter of 1970 to 4.12 percent by the final quarter, theoretically to jump-start the economy. The rate of inflation was 4.55 percent at the end of that year, sending real interest rates below zero.

Burns’ successor, G. William Miller, was inexperienced, and served a scant 18 months until August 1979, when Paul Volcker was sworn in. Monetary policy had failed to stop inflation, and the Fed’s credibility eroded. The FOMC had engaged in a “go-stop” policy that loosened money to reduce unemployment by stimulating output. But when inflation grew, worries loomed, and when the FOMC tightened money by raising the federal funds rate, the policy could throw the economy into recession.

In this fashion, people began to expect inflation as inevitable and factor it into buying decisions, fueling even higher prices.

Richmond Fed’s first president with a doctorate in economics was Bob Black, who began his term in 1973. He’d been president six years, a voting FOMC member every third year, when he got Volcker’s call on Oct. 6, 1979, for a special meeting. Volcker wanted to change the Fed’s procedures. He wanted to set the quantity of reserves rather than the price, the federal funds rate. Theoretically, the funds rate would then settle appropriately — if the money supply was targeted correctly. A fortuitous by-product was that this relieved the Fed of rate-setting responsibility. In 1982, inflation declined, and the Volcker Fed returned to targeting price rather than quantity of balances. Ultimately, inflation...
fell from a high of 13.5 percent in 1980 to under 4 percent a few years later, and maintained a low rate. Today, the Fed’s implicit inflation target is about 2 percent.

The Volcker disinflation, as the era is now called, advanced the idea that stable prices are paramount; expectations, whether of inflation or deflation, can influence economic activity.

Dissents were more frequent then, as policy was being worked out. For instance, though Black agreed with Volcker’s overall strategy, he dissented often over nuances of policy. He once apologized to Volcker before voting by stating: “Mr. Chairman, it pains me to have to dissent again.” He favored lower short-run money targets than the committee as a whole thought appropriate.

The Bernanke and Greenspan years seem downright calm, dissent-wise, compared to the 1970s and early 1980s. For example in 1978, members dissented 19 times in 10 of 19 meetings. In 1979, there were 20 dissents in 13 meetings, and in 1980, there were 25 dissents at 13 of 17 meetings during the year.

A longer time span shows that about 8 percent of all voting observations from 1966 to 1996 were dissents, according to economist Rob Roy McGregor of the University of North Carolina at Charlotte. From 1987 through 1999, that proportion declined to 6 percent. He has co-authored a book about FOMC decisionmaking, and says the combination of professionals and advanced knowledge may have contributed to less disagreement. “The decline in dissent might have to do with the greater number of economists, but combined with that is the sense that we have a reasonably unified framework that the committee can use.”

Today, McGregor says most economists believe as Milton Friedman instructed: Inflation is a monetary phenomenon, not fundamentally driven by union or monopoly-firm wages. “That issue has become settled in the last 40 years and taken for granted by committee members.” The idea that there may be a short-run trade-off but no long-run trade-off between inflation and unemployment, McGregor confirms, is fairly well accepted.

Poole’s dissents were typically hawkish, but he also dissented for other reasons. He dissented in January 2008, at a conference-call meeting held one week prior to the scheduled meeting. He saw no reason for action one week ahead. “I also believed the market would interpret the FOMC’s action as a response to the decline in equity prices in Europe,” he explains. The stock market at home was closed because of a holiday. “And the Federal Reserve had always argued that it did not respond to the stock market.”

That notion of systematic, expected policy decisions is paramount on the committee, and reflects academic work on rational expectations in the 1970s, particularly that of Nobel Laureate Robert Lucas. Before this idea had taken root on the FOMC, members couldn’t fully appreciate the need to make decisions that would not shock the market.

Poole cites, by way of example, that three strong employment reports in succession would have the market...

Monetary policy is a central concern of the Federal Open Market Committee (FOMC). "That's what you might call 'Son of Monetarism,'" former FOMC member Kenneth C. "Poole says, "the market should behave as policymakers expect and policymakers behave as markets expect."

The 13th Member: The Committee

Contributing to agreement is the committee itself, where consensus is valued. Most members would say that the chairman never loses. A chairman has never been outvoted nor will he ever be, Poole observes.

Yet there's always a measure of dissent and disagreement. That produces healthy debate among the large number of well-trained economists, many of them from the Reserve Banks, and of course Bernanke himself is a thoroughly trained economist, Broadus says. Take the idea of inflation targeting, for which Broadus, Bernanke, and others have argued. "Others opposed it. If you have deflation developing but the Fed is aiming for between 1 percent and 2 percent, if that target is there, people will think the Fed will do what they have to do. Others don't find that argument persuasive. That's an important debate. And it's no less intense than the old Keynesian-Monetarist debate."

Today, new disputes have sprung up, including ones over the fine points of that earlier divide. The trade-off between short-term unemployment and inflation can provoke differences, Poole notes, as well as the nature of the process by which inflation expectations are created or changed.

Monetarism, Broadus says, has morphed into the view that what really matters is for the Fed to clearly state its inflation objective. "That's what you might call 'Son of Monetarism.'"

More than two dissents are rare on the committee. "A third, however, would be viewed as a sign that the FOMC is in open revolt with the Chairman's leadership," former Fed governor Laurence Meyer wrote in his book, *A Term at the Fed*. That would disrupt the process of monetary policymaking and unsettle financial markets.

Disagreement can stem from many quarters, for instance, the ballooning of the Fed's balance sheet. Jeffrey Lacker, current Richmond Fed president, dissented at the Jan. 27-28, 2009, FOMC meeting. It wasn't because he disagreed with expanding the monetary base, but because he preferred to buy U.S. Treasury securities rather than target credit programs through the Term Auction Lending Facility.

Some economists think that "providing financial assistance to particular entities is more like fiscal policy than monetary policy," Poole notes. He adds that today there are probably new significant disputes, and cites the "too big to fail" concept, the Fed's credit policies, and debate over whether the Bear Stearns bailout was a good idea as examples.

Recorded dissents don't necessarily reveal members' preferences. Disagreement may not result in dissent, and those can be probed only through the verbatim transcripts of meetings. But the Reserve Bank presidents frequently give speeches, in which they may detail ideas about monetary policy, whether or not they've dissented. In this fashion, they plant ideas in the public discourse. These discussions also appear to be a way of informing the market, by conditioning expectations. The federal funds target today is 0 percent to 0.25 percent, for example, and Kansas City Fed President Thomas Hoenig has dissented at each meeting this year, signaling his inflation concerns. In contrast, President James Bullard from the St. Louis Fed has not dissented, yet has spoken out regarding his concerns about deflation, another signal to markets. FOMC statements today employ the phrase "extended period" to tell the market the rate will stay low until there's a compelling reason to move it.

And so while economists may have reached broad agreements on certain macroeconomic principles, voting members are likely to disagree as discussions proceed, in search of the best policy path. But members do seem to agree on this: Predictability is paramount, with the market’s expectations aligned with those of policymakers.

**Readings**


